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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 249

CLINTON S. LUTKINS, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions, findings of fact and conclusions of law of the Court of Claims (Pet. App. A, 1-20) are reported at 312 F. 2d 803.

JURISDICTION

The judgment of the Court of Claims was entered on February 6, 1963 (Pet. App. A, 1, 20), and a timely motion for rehearing was denied on April 5, 1963 (Pet. App. C, 1-2). The petition for a writ of certiorari was filed on July 1, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Section 112(g)(1)(B) of the Internal Revenue Code of 1939 defined a tax free reorganization to include the acquisition by one corporation, in exchange solely for its voting stock, of at least 80 percent of the stock of another corporation. The question presented is whether the acquisition by one corporation of 29.489 percent of the total stock of another in exchange for voting stock, qualifies as a tax free reorganization where, because of the acquiring company's existing holdings of such stock, acquired in part for cash, the acquisition results in its owning more than 80 percent of the stock.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * *

(b) *Exchanges Solely in Kind.*—

* * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * *

(g) [as amended by Sec. 213(b), Revenue Act of 1939, c. 247, 53 Stat. 862 *et seq.*] *Definition of Reorganization.*—As used in this section (other than subsection (b)(10) and sub-

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section (l)) and in section 113 (other than subsection (a)(22))—

> (1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.
>
> * * * *

(26 U.S.C. 1952 ed., Sec. 112.)

STATEMENT

The pertinent facts were stipulated by the parties and may be summarized as follows (Pet. App. A, 16-20):

In 1912, American Machine & Foundry Company ("American") exchanged 11,000 shares of its own voting stock for 65,375 shares of the capital stock of International Cigar Machinery Company ("International") plus other consideration not material to this case. The 65,375 shares of International represented 65.375 percent of International's total stock. (Pet. App. A, 16-17.)

At various times over the following 40 years, American made relatively small cash purchases of International stock, so that its ownership at the beginning of 1952 constituted 68.066⅔ percent of International's total stock.[1] In April 1952 American offered to exchange its own voting stock for the capital stock of International at a rate of 1⅓ shares of American for each share of International. Pursuant to this offer it issued 235,918⅔ shares of its own voting stock for 176,939 shares of International's stock, which represented 29.489 percent of International's total issue. (Pet. App. A, 18.)

George and Lena Arents together owned 18,100 shares of International stock which they exchanged in accordance with the terms of the offer for 24,133⅓ shares of American voting stock. They reported a capital gain of $283,931.32 on their 1952 joint income tax return. In 1954 they filed a claim for the refund of taxes alleged to have been erroneously paid on the gains realized from the exchange. The claim was disallowed in full. (Pet. App. A, 19-20.)

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[1] As a result of stock splits in 1927 and 1930 the number of shares held by American in 1952 was 408,400.

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A suit for refund, in which the taxpayers were succeeded by their executors, was duly brought in the Court of Claims. The court, with one judge dissenting, held that the 1952 exchange of American stock for International was not pursuant to a plan of reorganization within the meaning of § 112(g)(1)(B) of the Internal Revenue Code, and that any gain resulting therefrom was taxable. (Pet. App. A, 1-8, 20.)

ARGUMENT

1. The taxpayers' gain from the exchange of their International stock for American stock was nontaxable under § 112(b)(3) and (c)(1) only if the exchange was pursuant to a "reorganization" as defined in § 112(g)(1). See *Turnbow* v. *Commissioner*, 368 U.S. 337. Section 112(g)(1)(B), the only definition invoked by petitioners, defines as a reorganization—

> the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the * * * stock of another corporation * * *.

Standing alone, the 1952 transaction—by which American acquired less than 30% of the stock of International—obviously could not qualify as a reorganization since it was not an "acquisition * * * of at least 80 per centum" of International's stock. To establish an acquisition of the required amount of stock it would be necessary to combine the 1952 acquisition with American's prior acquisitions beginning in 1912. The Court of Claims assumed

arguendo that the several acquisitions could be combined to meet the definition but held that even so they failed to qualify as a "B" reorganization. Since in the course of acquiring the required 80% of International's stock American had acquired 2.691% of the stock for cash (Pet. App. A, 17), the acquisition was not, the court held, "in exchange solely * * * for voting stock."

The court's holding that the payment of cash for a part of the stock prevented a reorganization even though only voting stock was given for more than 80% of the stock is fully consistent with the language of the statute and is supported by *Howard* v. *Commissioner*, 238 F. 2d 943 (C.A. 7),[2] and *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C.A. 2). See also *Helvering* v. *Southwest Consolidated Corp.*, 315 U.S. 194. There is no conflicting decision and no other reason for review of that holding by this Court.

Moreover, the premise of petitioners' argument that the 1952 acquisition could be combined with the prior acquisitions for purposes of meeting the statutory definition, although accepted *arguendo* by the Court of Claims, seems plainly contrary to the statu-

[2] Our reference is to the first holding of the *Howard* case—*i.e.*, the holding that the transaction there involved did not qualify as a "B" reorganization because cash had been given in exchange for a small part of the stock. The second holding—that the "boot" provision, § 112(c)(1), made the taxpayers' gain nontaxable notwithstanding the failure to qualify as a reorganization—was overruled by *Turnbow* v. *Commissioner*, 368 U.S. 337. Since the first holding of *Howard* supports the decision below and the second was overruled, we are at a loss to understand petitioners' assertion of a conflict with that case (Pet. 6-7).

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tory language. Section 112(b)(3) provides for non-recognition of the taxpayers' gain only if their exchange was "in pursuance of the plan of reorganization." Since a "B" reorganization requires the "acquisition" of "at least 80 per centum" of the acquired corporation's stock, it seems evident that a "plan of reorganization" must contemplate the acquisition of at least that amount of stock. Thus, if two or more partial acquisitions of stock, separated in time, are to qualify as a reorganization, they must at the very least have been made pursuant to a single "plan." Here there is of course no claim that the 1912 exchange and the 1952 exchange were parts of a single "plan" for the acquisition of the required 80% of International's stock. They cannot therefore be combined to meet the 80% requirement.[3]

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[3] See also 3 Mertens, *Law of Federal Income Taxation* (Rev.), Sec. 20.89, which states:

> The 1939 Code described the instant type of reorganization * * * as the *acquisition* by one corporation "of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock" of another corporation. Under the 1939 Code, therefore, there was a serious question whether the statutory definition could be satisfied if the acquired stock was in a quantity less than such 80% interest. Thus, the acquiring corporation may already have acquired 10% of the stock of the acquired corporation in exchange solely for its own voting stock. Was the *acquisition* by such corporation, in a subsequent separate transaction, of an additional 75% an acquisition of *at least 80%* of the voting stock *and at least 80%* of the total number of shares of all other classes of stock of another corporation? Although there was room for a difference of opinion, it seemed reasonably clear that such a transaction was not the *acquisition* of an 80% interest as required by the statute. * * *

2. In any event, because of the changed definition of a "B" reorganization in the 1954 Code, the basic question presented by this case is confined to the 1939 Code and is unlikely to recur.

The Internal Revenue Code of 1954 amended the corporate reorganization provisions so that § 368 (a) (1) (B) now includes within the definition of a "B" reorganization *any* exchange solely for voting stock of the acquiring corporation which results in ownership of more than 80 percent of the total stock of the acquired corporation, no matter how much ownership the acquiring corporation held before the exchange and irrespective of the consideration it gave to acquire such ownership. Congress recognized that "there is doubt as to whether the existing statute [the 1939 Code] permits such an acquisition tax free when the acquiring corporation already owns some of the voting stock of the other corporation," and it enacted the amendment to remove the doubt. S. Rep. No. 1622, 83rd Cong., 2d Sess., 273 (1954) (which also suggests a hypothetical example similar to the facts of the present case). Thus it appears that the 1954 law would clearly render nontaxable an exchange of the sort here involved.[4] Consequently the question

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[4] See Bittker, *Federal Income Taxation of Corporations and Shareholders* (student ed. 1959) 364-365:

> Section 368(a)(1)(B) [of the Internal Revenue Code of 1954] does not require that control of the acquired corporation be obtained in the reorganization itself. Evidently the acquisition of stock in any quantity will suffice, so long as the acquiring corporation has the requisite "control," as defined by § 368(c), immediately after the exchange. In this respect, § 368(a)(1)(B)

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presented by this case is a dead issue which does not require resolution by this Court.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

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changes pre-1954 law, under which it seemed to be necessary to acquire 80 percent of the acquired corporation's stock in the reorganization itself, so that a corporation that had purchased over 20 percent of another corporation's stock in the past could not use a Type B reorganization to increase its ownership. * * * By virtue of the 1954 change in the phraseology of § 368(a) (1) (B), the acquiring corporation need not obtain "control" in one fell swoop; a "creeping acquisition" of stock (*e.g.*, 10 percent of the stock of a corporation of which the acquiring corporation already owns 75 percent) will qualify, as well as an increase in ownership by a corporation that already has "control."

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